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ECONOMIC SITUATION IN S. VIETNAM

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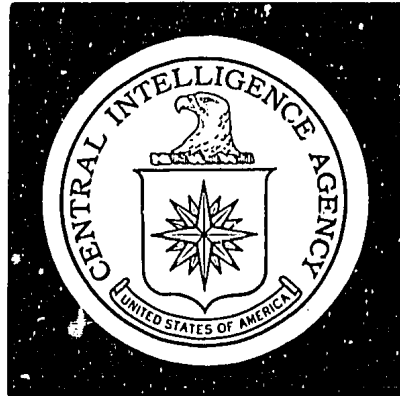
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Situation In South Vietnam

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
January 1971

INTELLIGENCE MEMORANDUM

The Economic Situation In South Vietnam

Introduction

By 11 January, retail prices in Saigon had increased only 1% above the average level of December, but they probably will increase somewhat more during the month as the result of pre-Tet buying and the US sector wage increase granted late in December.

Developments in South Vietnam during 1969 and 1970 show that price trends have differed greatly from trends in the money supply. Retail prices in Saigon rose 34% in 1969 and 30% in 1970, while the money supply increased only 13% and 10% in these two years, respectively. The experience of 1969-70 suggests that: (a) government expenditures (particularly wage increases) and imports were the two most important factors affecting the growth of liquidity, and (b) speculative activity rather than increases in money supply was responsible for most of the price increases. This speculation was reflected in an increase in the velocity of circulation of money and huge windfall profits by importers.

Charts on money supply and prices, foreign exchange reserves, import licensing, gold prices and currency, and the government budget follow the text.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research.

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Recent Developments

Prices

1. Retail prices and black market rates continued relatively stable early in the new year. The average price level in Saigon declined slightly during December 1970, and by 11 January the USAID index was only 1% above that level. Prices probably will rise somewhat more during the remainder of January as the annual splurge of buying for Tet (27-29 January) gets under way.

2. Saigon black market currency and gold prices have remained virtually unchanged since early November. On 12 January, dollars and MPC (scrip) were 391 and 268 piasters per dollar, respectively, compared with the legal rate of 275 piasters per dollar. The price of a dollar's worth of gold leaf was 490 piasters.

Wages

3. In order to forestall further labor troubles, a wage increase was granted in late December to the approximately 120,000 Vietnamese employed by US military and civilian organizations and their contractors. Thousands of employees of US construction companies had engaged in a month-long strike last October demanding a 10%-30% wage increase and other benefits. Moreover, a wage survey conducted a few months after the pay increase of April 1970 indicated that US sector wage rates lagged about 35% behind those of the private sector. The latest wage increase averages 11.2%, with employees in lower pay brackets receiving a larger percentage increase than those at higher pay levels. Wages in the US sector still lag behind those in the private sector, but GVN civilian and military pay rates are even further behind, despite the 17% increase granted in October.

Monetary and Price Developments, 1969-1970

4. Viewed on an annual basis, monetary developments and price movements in South Vietnam in 1970 were much the same as in 1969. Retail prices, as measured by the USAID monthly average

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index for Saigon, rose 30% in 1970 and 34% in 1969. The money supply, on the other hand, increased only about 10% and 13%, respectively, in the two years -- much less than had been expected. These developments point up the difficulties of trying to forecast price changes in South Vietnam from changes in the money supply.

5. In both 1969 and 1970 the growth of money supply was considerably smaller than expected. In 1969, officials overestimated GVN expenditures and underestimated the amount of money that would be taken out of circulation by imports and import taxes. Because of the large increase in austerity taxes on imports in late October 1969, the government wage increase which took effect that month and raised government expenditures considerably caused very little increase in the money supply.

6. Predictions of mounting budget deficits in 1970 were not borne out at least until after mid-year. The few statistics available suggest that GVN expenditures were fairly stable through June while receipts were high because of the application of austerity taxes to unusually large import arrivals. The result apparently was an approximate balance between GVN receipts and expenditures during the first half of the year, as indicated by stability in the government's debt to the Central Bank. In the second half, however, the GVN debt to the bank increased by nearly 5 billion piasters a month, mainly because of a drop in import arrivals -- which in turn was a lagged effect of restrictive import licensing policies since early 1970. It is too early to see the total effect of the October reforms on government receipts and expenditures. The wage hikes will raise expenditures while higher import taxes and exchange rates and more liberal import licensing will raise revenue.

7. While the money supply was nearly stable during the first half of the year because of the near absence of GVN deficit financing, it increased much less than the government deficit in the second half. Although during June-November the government pumped about 25 billion piasters into the economy (total expansion of liquid assets was 30 billion piasters, see the table), the money supply increased

South Vietnam: Net Money Supply

Billion Piasters

	Dec 1969	1970										
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Expansionary factors	<u>180.3</u>	<u>194.7</u>	<u>197.4</u>	<u>193.5</u>	<u>193.9</u>	<u>195.1</u>	<u>194.8</u>	<u>198.2</u>	<u>203.2</u>	<u>208.9</u>	<u>216.1</u>	<u>224.5</u>
International assets	19.4	19.9	18.5	16.8	15.1	15.5	15.0	15.9	16.1	17.4	17.4	18.2
Financing of business	29.3	33.0	35.7	37.0	38.6	39.1	35.5	35.5	33.9	33.3	35.1	37.7
Financing of government (net)	131.6	141.8	143.2	139.7	140.2	140.5	144.3	146.8	153.2	158.2	163.6	168.6
Contractionary factors	<u>39.6</u>	<u>42.8</u>	<u>43.9</u>	<u>43.5</u>	<u>45.1</u>	<u>46.4</u>	<u>45.8</u>	<u>46.5</u>	<u>46.9</u>	<u>56.3</u>	<u>63.8</u>	<u>68.7</u>
US deposits	7.3	8.1	7.8	6.0	7.1	7.0	7.0	8.4	8.0	9.3	9.1	9.4
Savings and term deposits of private sector	26.7	28.9	28.4	28.4	27.1	27.8	26.3	26.6	26.6	29.6	32.6	35.3
Other factors ^a /	5.6	5.8	7.7	9.1	10.9	11.6	12.5	11.5	12.3	17.4	22.1	24.0
Net money supply	<u>140.7</u>	<u>151.9</u>	<u>153.5</u>	<u>150.0</u>	<u>148.8</u>	<u>148.7</u>	<u>149.0</u>	<u>151.7</u>	<u>156.3</u>	<u>152.6</u>	<u>152.3</u>	<u>155.8</u>

a. Including reserve requirements of banks, interbank deposits, advance deposits on imports, and errors and omissions. The largest item in recent months is advance deposits on imports.

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by less than 7 billion piasters. Such a major divergence between the growth of available liquidity and the growth of the money supply is a new phenomenon in South Vietnam and is a direct result of the September/October financial reforms. Rapid sustained inflation and controls which kept interest rates far below the rate of inflation had long induced the Vietnamese to hold their financial assets in the most liquid possible form -- that is, as currency or demand deposits. Private savings and time deposits were insignificant. The removal of ceilings on interest rates in September evidently was an immediate inducement to build up savings deposits, which increased rapidly between August and November. The imposition of advance deposits on imports in October also froze substantial private funds. Indeed, to obtain the necessary funds, some importers had to repatriate money they had sent abroad.

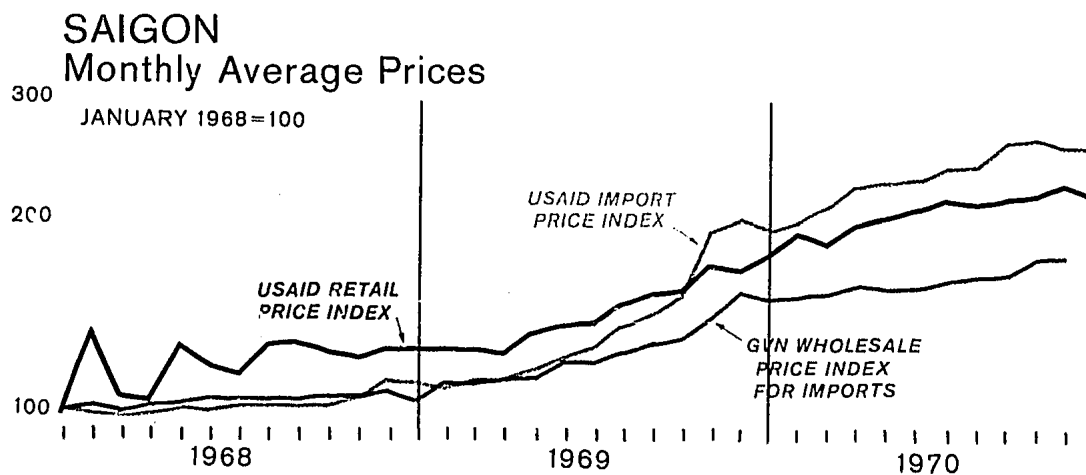
8. For lack of any better, practicable analytical tool, official projections of price changes in South Vietnam have relied largely on estimates of the change in money supply. Averaged out over several years, increases in prices and money supply have been roughly proportional (see the chart on money supply and prices following the text). On an annual basis, however, monetary creation has not been a good predictor of inflation, and the relationship has been especially poor in the past two years. In 1969 and 1970, speculative activity, rather than growth of the money supply, was responsible for most of the increase in prices. Speculation in rice triggered by a decline in government stocks boosted the price level during May-October 1969. The substantial increase in austerity taxes decreed in October 1969, which was badly handled by the government, and the tightening of import licensing caused considerable confusion in the market and led to further speculation as merchants, farmers, and importers tried to anticipate the government's next move. This speculative activity was reflected in an increase in the velocity of circulation of money. In 1969, velocity (the rate at which money changes hands) increased roughly 20%, with most of the increase occurring in the last half of the year. In 1970, velocity further increased about 25% during the first seven

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months (which made the 12-month increase nearly 50%) and remained stable at that high level during the remainder of the year. The USAID retail price index followed much the same pattern as velocity in both years. Velocity generally has been high in periods of relative security and low in periods of relative insecurity, such as in 1965 and in 1968 in the aftermath of the Tet offensive.

9. Speculation by importers was one of the most troublesome economic problems facing the government during the past year. Importers began large-scale ordering of goods following the austerity tax increase in 1969, anticipating that a devaluation would be forthcoming. In February 1970 the government clamped down on licensing, a move which encouraged importers to raise prices further even though their costs did not increase. Even when domestic prices began to level off in July, import prices continued to increase because of both continued speculation about devaluation and reduced arrivals of goods resulting from the licensing restrictions earlier in the year. An enormous increase in importers' profits is implied by the large gap which developed since late 1969 between the USAID import price index and the GVN wholesale price index (which can be taken to represent importers' costs), as shown in the following chart.



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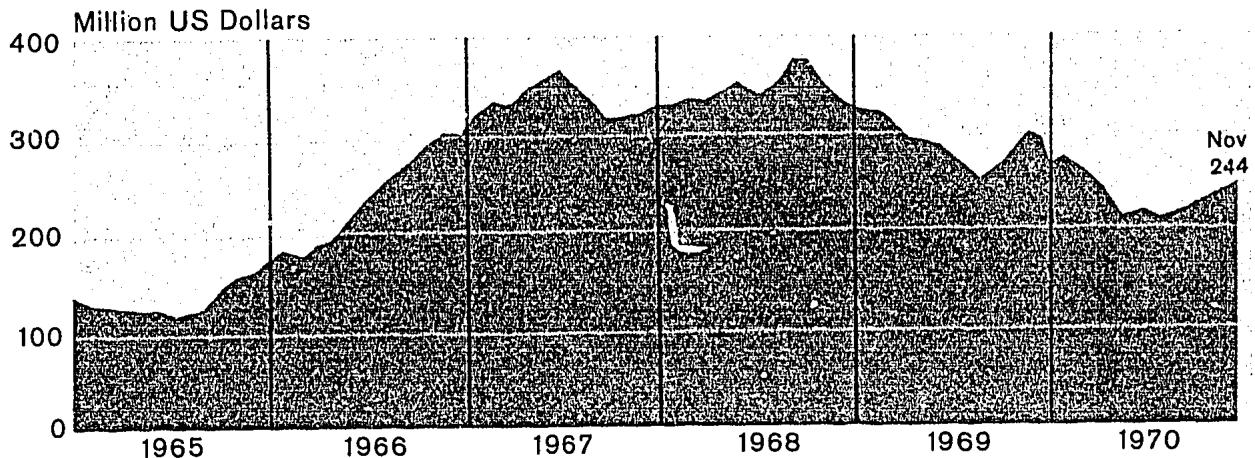
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10. The chart also indicates that the measures enacted in October 1970 to curb windfall profits -- higher interest rates, open licensing, and partial devaluation -- have begun to be effective. Surveys taken by the Embassy of the landed cost and market price of various imported goods indicate that, although profit margins still are substantial, profits have dropped considerably since October.

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SOUTH VIETNAM

Foreign Exchange Reserves*

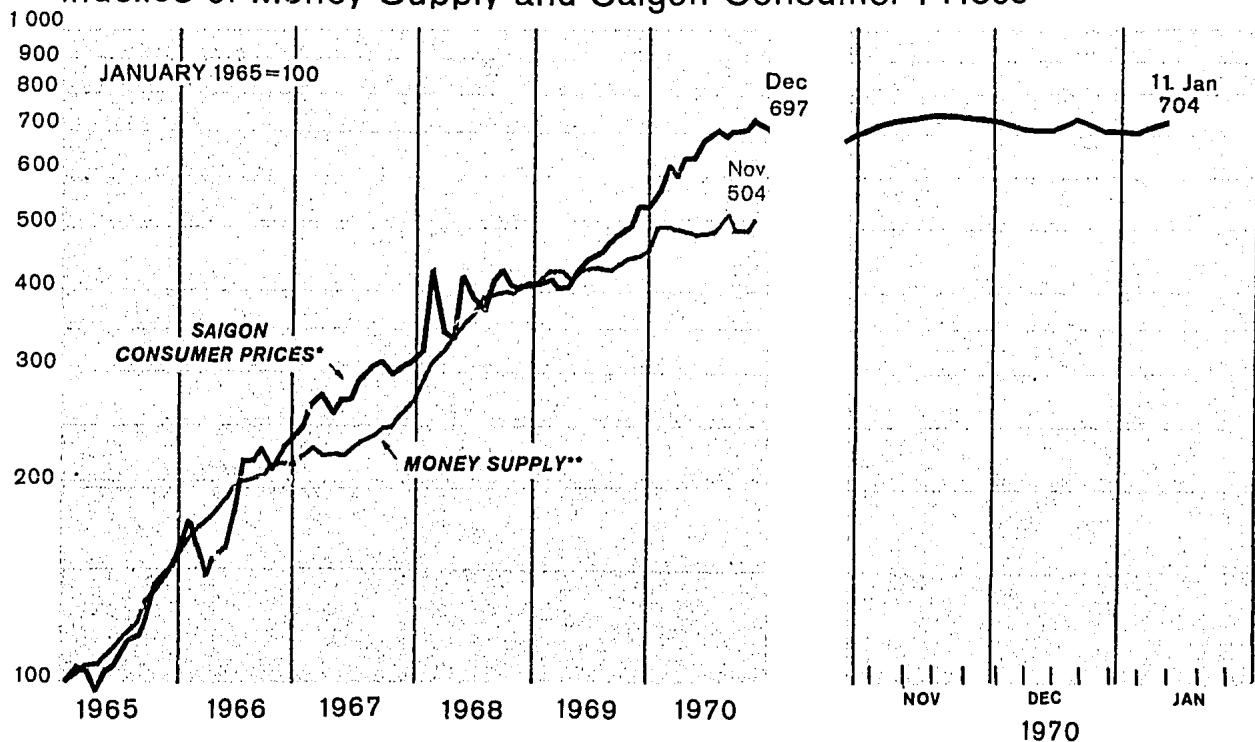


*Excluding holdings of commercial banks

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SOUTH VIETNAM

Indexes of Money Supply and Saigon Consumer Prices



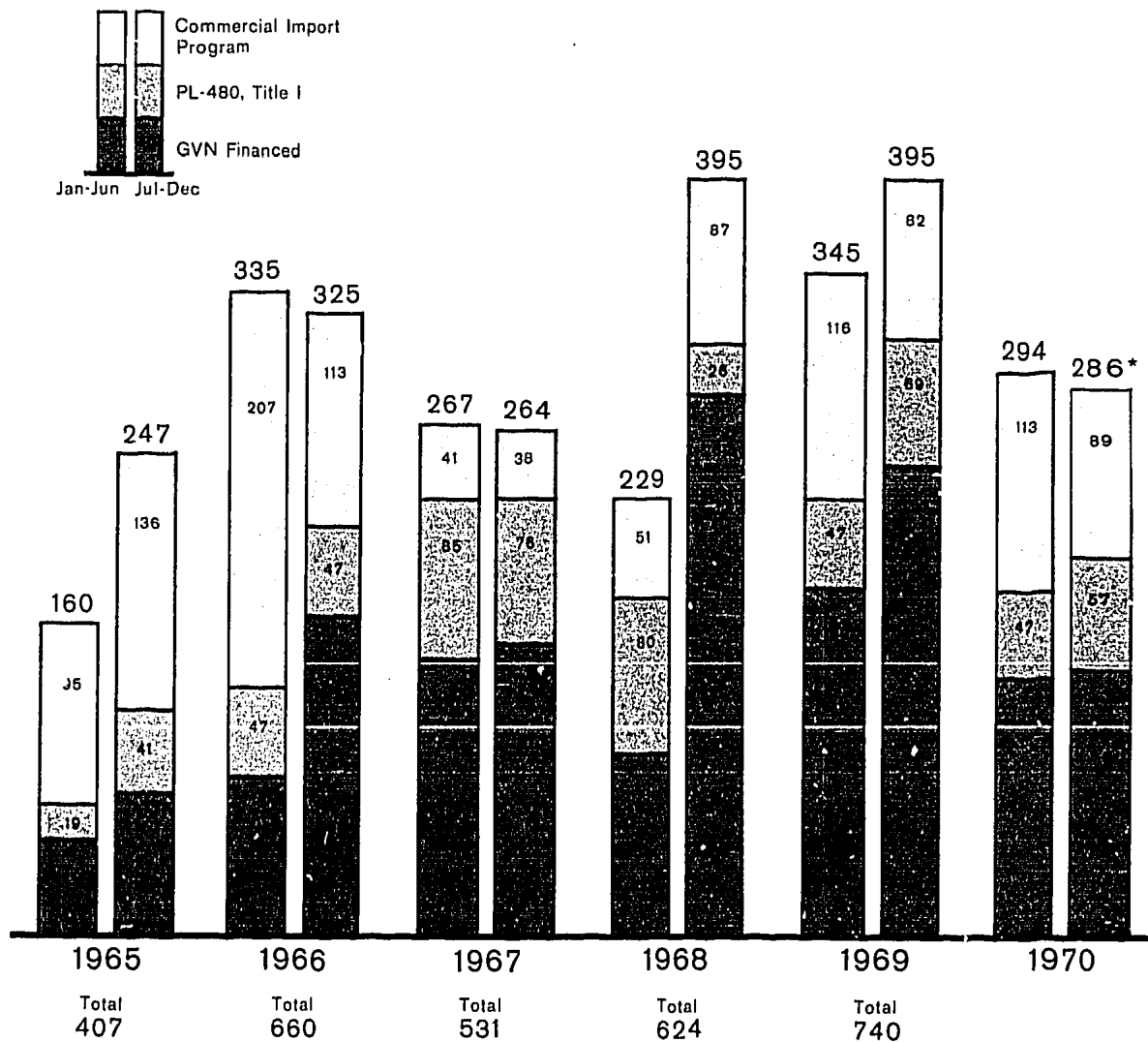
*USAID monthly average retail price index for Saigon

**Data are for end of month

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IMPORT LICENSING

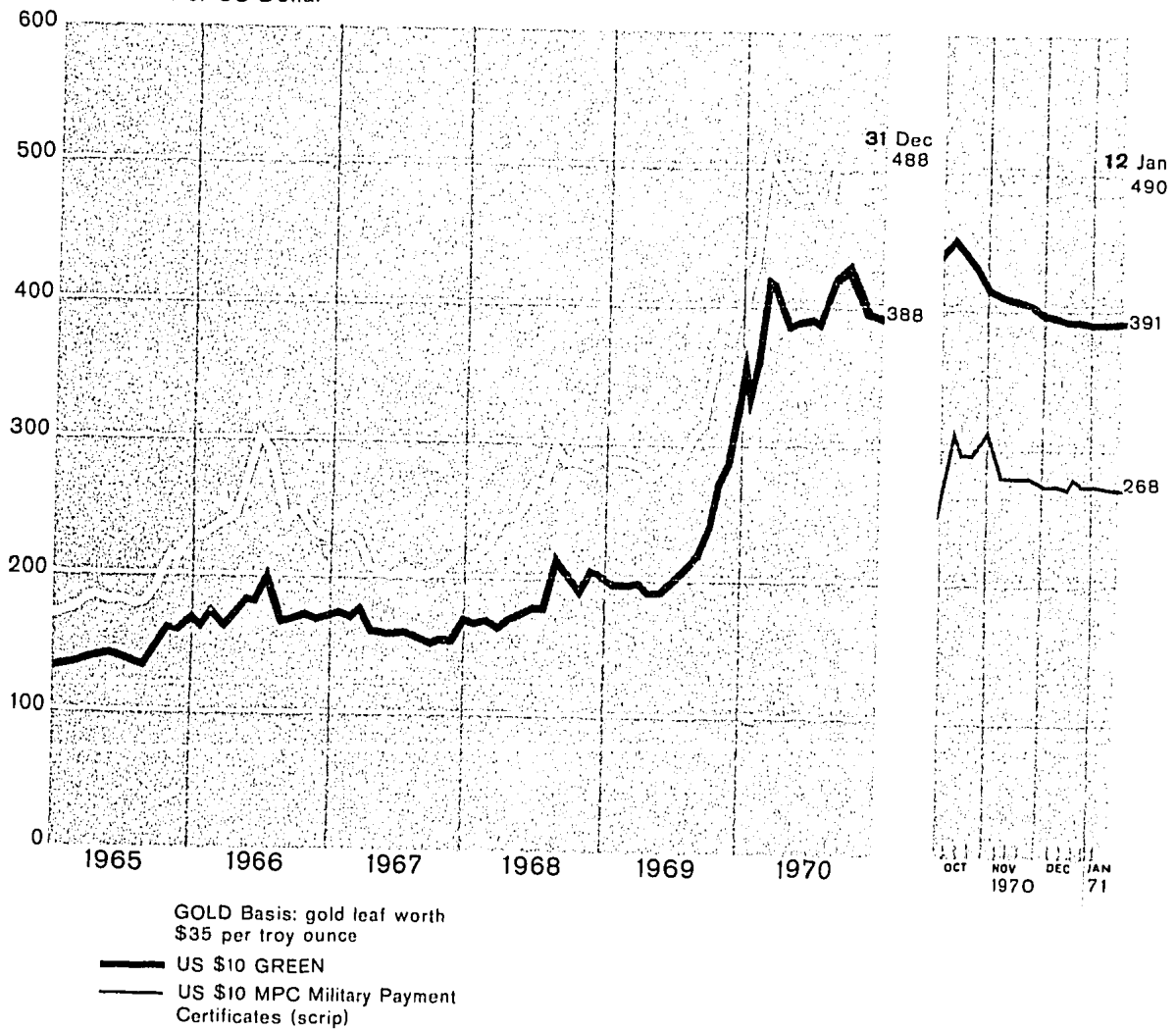
Million US Dollars



*July through November only

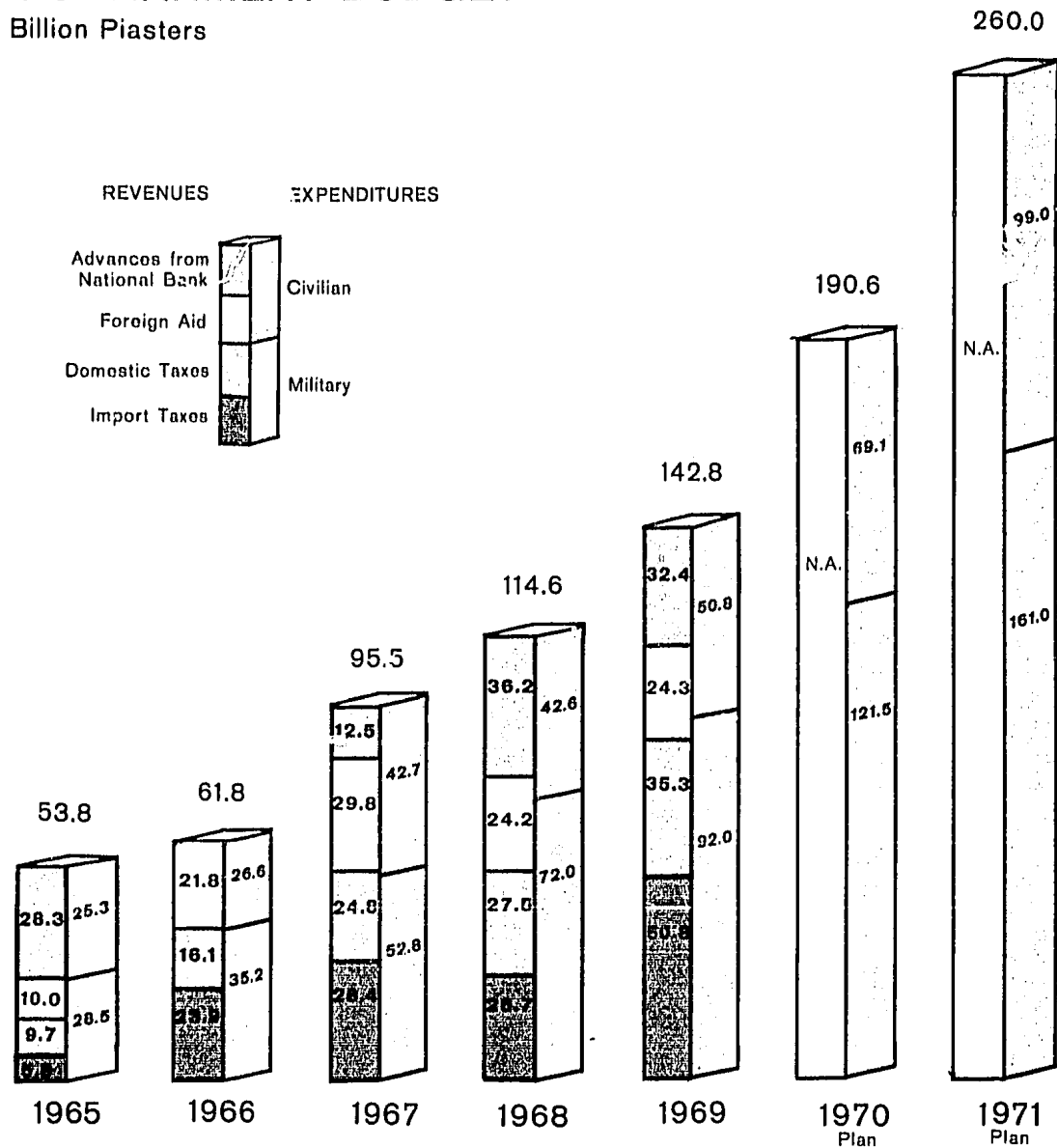
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SAIGON
Free Market Gold and Currency Prices
Piasters Per US Dollar



GOVERNMENT BUDGET *

Billion Piasters



*Data include extrabudgetary revenues and expenditures

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